FILE COPY

SEP 12 1

CHARLES ELMORE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 374

ROSS C. ADAMS, Receiver of the Farmers National Bank of Pekin, Illinois, Petitioner,

vs.

EDWIN V. CHAMPION, Trustee in Bankruptcy of JOHN FITZGERALD, Bankrupt, Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit and Brief in Support Thereof.

JESSE BLACK, JR.,
JOHN F. ANDERSON,
Attorneys for Petitioner.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX.

Page

I. The Case 1

II. Summary of Matters Involved 2

III. Reasons for Granting the Writ 6

The Facts in the Case are not in Dispute. Petitioner Complains of the Construction of Said Facts as a Matter of Law Wherein it was Held that by Virtue of the Doctrine of Schumacher v. Harriett, *supra*, Tracing to the Bank Receiving of the Proceeds of the Four Items Has Been Shown in the Instant Case 6

Brief in Support of Petition 9

I. Opinions Below 9

II. Jurisdiction 9

III. Statement of Case 10

IV. Specification of Errors 10

V. Summary of Argument 11

VI. Argument 12

A. The Necessary Elements of a Preferred Claim, and the Rule Stated as to Augmentation and Tracing 12

B. The Appropriation of a Deposit or Credit Balance Does not Result in Augmentation but Merely in a Shifting of Bookkeeping Credits. 15

C. There was no Valid Basis for Attempting to Impress the Cash in the Bank With a Trust in Favor of the Trustee in Bankruptcy Based Upon the Bank's Receipt and Subsequent Surrender of the Four Trust Items 20

Page

D. The Tracing of Funds Doctrine of Schumacher v. Harriett, 52 Fed. (2d) 817, Relied on by the Appellate Court for the Allowance of a Preferred Claim in the Instant Case is Erroneous Because in Conflict With the Decisions of this Court and Many Decisions of the United States Circuit Court of Appeals..... 21

Conclusion 24

CASES CITED.

Allied Mills v. Horton, 65 Fed. (2nd) 708..... 17
American Can Co. v. Williams, 178 F. 420.....7, 15, 23
American Can Co. v. Williams (C. C. A. 2), 176 F. 816. 7
Anadarko Cotton Oil Co. v. Litteer 300 F. 222..... 24
Banking Co. v. Fourth Nat. Bank, 38 F. (2d) 772..... 24
Beard v. Independent District of Pella City (C. C. A. 8), 88 F. 375 .....7, 15
Blakey v. Brinson, 286 U. S. 254, 262.....6, 15, 17, 22
Blumenfeld v. Bank, 38 Fed. (2nd) 455..... 15
Brennan v. Tllinghast, 201 Fed. 609, 612, 613.....15, 24
Burnes National Bank v. Spurway (C. C. A. 8), 28 F. (2) 40 7
City of Miami v. First National Bank, 69 Fed. (2nd) 346 17
Commissioners of Crawford County v. Strawn, 157 F. 49, 15 L. R. A. (N. S), 1100..... 24
Cunningham, Trustee of Ponzi v. Brown, 265 U. S. 1, 11 .....6, 15
Cuttell v. Fluent, 51 F. (2) 974 24
Dickson v. First National Bank (C. C. A. 8), 26 F. (2) 411 .....7, 24
Dudley v. Richards, 18 F. (2d) 876..... 24
Ellerbe v. Studebaker Corp., 21 Fed. (2nd) 993..... 17

Page

Empire State Surety Co. v. Carroll County (C. C. A. 8), 194 F. 593 ..... 7, 13, 23
Farmers National Bank v. Pribble (C. C. A. 8), 15 F. (2) 175 7
First National Bank, St. Petersburg v. City of Miami, 69 Fed. (2d) 346 23
First Nat. Bank v. Fidelity & Deposit Co., 48 F. (2d) 585 24
First National Bank v. Williams (C. C. A. 4), 15 F. (2) 585 7
Gwynn v. Spurway, 28 F. (2d) 37 24
Hirning v. Federal Reserve Bank, 52 Fed. (2nd) 382 ..... 15, 16
Horse Co. v. Americus Nat. Bank, 230 F. 738 24
Jenkins, Receiver, v. National Surety Co., 277 U. S. 258 8
Larabee Flour Mills v. First National Bank of Dublin, 69 Fed. (2nd) 351 17
Larabee Flour Mills v. First National Bank (C. C. A. 8), 13 F. 330, certiorari denied 273 U. S. 727 ..... 7, 15, 17
Macy v. Roedenbeck, 227 F. 346, 355 24
Mechanics & Metals National Bank v. Buchanan (C. C. A. 8), 12 F. (2) 891 7
Pottorff v. Key, 67 Fed. (2d) 833 23
Pottorff v. Texas & Pacific R. R., 291 U. S. 245, 261 6
Rorebeck v. Benedict Flour & Feed Co. (C. C. A. 8), 26 F. (2) 440 7
Sanders v. Stevens, 51 F. (2d) 743 24
Schilling v. Rowe (C. C. A. 9), 64 F. (2) 188 7
Schuyler v. Littlefield, 232 U. S. 707, 713 ..... 4, 5, 6, 15, 20
Schumacher v. Harriett, 52 Fed. (2d) 817 6
Schumacher v. Brinson, 52 Fed. (2d) 821 22
Section 5236 United States Revised Statutes (Section 194, Title 12, U. S. C. A.) 12, 13

Page

Spurway v. Kellogg (C. C. A. 5), 63 F. (2) 883..... 7
St. Louis and San Francisco R. R. v. Spiller, 274 U. S. 304, 310 .....6, 15
Texas & Pacific Railway Co. v. Pottorff, Receiver, 291 U. S. 245, 261 .....20, 22
Titlow v. McCormick (C. C. A. 9), 236 F. 209.....7, 15, 24
United States National Bank v. Centralia, 240 Fed. 93, certiorari denied 243 U. S. 656..... 22
Wisdom v. Keen, 69 Fed. (2d) 349 23

Supreme Court of the United States

OCTOBER TERM, 1934.

No. ———.

ROSS C. ADAMS, Receiver of the Farmers National Bank of Pekin, Illinois, Petitioner,

vs.

EDWIN V. CHAMPION, Trustee in Bankruptcy of JOHN FITZGERALD, Bankrupt, Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

To the Honorable the Supreme Court of the United States:

Your petitioner, Ross C. Adams as Receiver of the Farmers National Bank of Pekin, Illinois, respectfully prays that a writ of certiorari issue to review the judgment and decree of the United States Circuit Court of Appeals for the Seventh Circuit, rendered in the above case (R. 82).

I.

THE CASE.

The United States District Court for the Southern District of Illinois, Northern Division, rendered judgment and decree (R. 69) allowing Edwin V. Champion, Trustee in Bankruptcy for John Fitzgerald, bankrupt, petitioner, a

priority claim against the cash in the Farmers National Bank of Pekin, Illinois, at its suspension. The Receiver of the suspended Bank appealed to the Circuit Court of Appeals and the judgment of the District Court was affirmed (R. 82) and Petitioner now seeks a review of the Decree of the Circuit Court of Appeals, Seventh Circuit. Petition for rehearing was denied June 13, 1931 (R. 113).

II.

SUMMARY OF MATTERS INVOLVED.

On June 24, 1930, the District Court of the United States, Southern District of Illinois, Northern Division, decreed (R. 24) that the Farmers National Bank of Pekin, Illinois, had obtained an unlawful preference from John Fitzgerald, a bankrupt, by taking certain collateral for his indebtedness, and directed the bank to turn over to Edwin V. Champion, the bankruptcy trustee (respondent in this case) said collateral or the proceeds. Prior to the entry of this decree and on January 7, 1932, the Farmers National Bank of Pekin, Illinois, had become insolvent and Ross C. Adams (the petitioner in this case), was appointed Receiver by the Comptroller of the Currency to wind up its affairs. The bank Receiver, pursuant to the aforesaid decree of the District Court, surrendered to the bankruptcy trustee all collateral received from the bankrupt (R. 37), except four items of an aggregate value of $8870.07 which had passed out of the hands of the bank prior to its suspension. The bank Receiver contended that the claim of the bankruptcy trustee in the amount of $8870.07 was general and not preferred, because the proceeds of the four items were not traceable into his hands as Receiver, whereupon the trustee in bankruptcy filed a petition in said District Court (R. 31) (this case) praying that the bank Receiver be directed to pay this sum in full. The bank Receiver answered averring that there had been no augmentation of the funds of the bank incident to the four items and that the proceeds

could not be traced into his hands as Receiver. After a hearing on the petition (R. 31-38), answer (R. 40), amendment (R. 44), and stipulation of facts (R. 49), the trial court held (R. 66-69), that the bank received the four items as trustee; that they were converted into cash by the bank, and used as its own, and by decree entered July 7, 1933 (R. 69), allowed the bankruptcy trustee a priority claim of $8870.07 against the bank Receiver.

The bank Receiver appealed to the United States Circuit Court of Appeals, Seventh Circuit (R. 71), and the Appellate Court affirmed the judgment of the District Court. Opinion, reported 70 Fed. (2d) 956, and set out in the record, page 82. Rehearing was denied June 13, 1934 (R. 113).

The record facts concerning the issue (which is the tracing of proceeds to the bank Receiver as to the four items received by the bank from the bankrupt and disposed of by it prior to suspension), are as follows:

ITEM 1. This item consisted of 10 shares of the capital stock of the Farmers National Bank, sold by it on February 9, 1929, to R. A. Cullinan for the sum of $3000, payment being effected by a charge against Mr. Cullinan's credit balance in the Farmers National Bank (R. 50, 51). A portion of the preferred claim allowed as to this item consisted of a $30 dividend on this stock (R. 50).

If it be material (which the bank Receiver denies) the credit balance from which payment for the above stock by Cullinan was effected was built up on the same day from the proceeds of a loan in the amount of $4000 made by the bank to Mr. Cullinan (R. 50).

ITEM 2. This item consisted of the Charles Graff note in the total amount of $3483.78, paid by Graff on April 12, 1929, by a charge against his deposit balance in the Farmers National Bank whereby two certificates of deposit were issued by the bank to its Vice President Reise and charged against Graff's account, in exchange for which the note was delivered to Graff (R. 51 and 54).

If it be material (which the bank Receiver denies) Mr. Graff deposited to his credit in the Farmers National Bank on April 12, 1929, items totaling $14,013.64. The proceeds of these items are traceable into the accounts of the Farmers National Bank with correspondent banks as follows: (1) Into the First National Bank of Peoria, Illinois, the low balance thereafter in said account being $51.41 (R. 51); (2) Into the First National Bank of Chicago, the low balance thereafter in said account being $70.54 (R. 52); and (3) Into a bank subsequently merged with the Commercial Merchants National Bank & Trust Company of Peoria, the low balance thereafter in said account being $351.94 (R. 53). The record does not contain affirmative proof that the bank receiver ultimately received anything from the correspondent banks having these low balances, except as to the First National Bank of Chicago where the sum of $643.24 admittedly due on the fourth item contains the prior low balance of $70.54, consequently even though these facts were material the claim is general only under the tracing of funds rule applied by this court in *Schuyler v. Littlefield*, 232 U. S. 707, 713.

ITEM 3. This item consisted of the W. C. Sommer note in the total amount of $1058.98 paid by Sommer on April 16, 1929, by a charge against his deposit balance in the Farmers National Bank whereby two certificates of deposit were issued by the bank to its Vice President, Reise, and charged against Sommer's account, in exchange for which the note was delivered to Sommers (R. 54).

If it be material (which the bank Receiver denies) Mr. Sommer deposited to his credit in the Farmers National Bank on March 27, 1929 (R. 55) a check in the amount of $14,055.60, drawn on that bank by T. M. Smith. The credit balance so drawn against by Mr. Smith was built up (R. 56, 57) by a prior deposit to his credit of items totaling $14,308.10. The only items included in Smith's deposit, concerning which the record contains affirmative proof of alleged augmentation and tracing, are items traceable into

the closed bank's balance with the First National Bank of Peoria, the low balance thereafter (November 28, 1930), (R. 51) being in the amount of $51.41, the same low balance referred to under the Graff item above, and items traceable into the now closed bank's balance with the Merchants & Illinois National Bank of Peoria, which later became the Merchants National Bank & Trust Company, the low balance thereafter (December 21, 1931) (R. 53), $351.94 the same low balance referred to under the Graff item above. The record does not contain affirmative proof that the bank receiver ultimately received anything from the correspondent banks having these low balances, consequently even though these facts were material the claim is general only under the tracing of funds rule applied by this court in *Schuyler v. Littlefield*, 232 U. S. 707, 713.

ITEM 4. This item consisted of five Veesaert mortgage bonds, which were involved in certain foreclosure proceedings, in the course of which the Farmers National Bank surrendered said bonds and received a check in the sum of $1597.31, drawn on the Edwardsville National Bank & Trust Company, the proceeds of which ultimately passed to the credit of the Farmers National Bank in its correspondent, the First National Bank, Chicago (R. 58). The low balance of Farmers National Bank in First National Bank thereafter was $643.24 (R. 59). This balance of $643.24 is traceable into the assets collected by the Receiver of Farmers National Bank from the First National Bank, Chicago (R. 59, 60).

If it be material (which the bank Receiver denies) when the Farmers National Bank closed on January 7, 1932, it had on hand in cash items $36,054.76. The least amount in cash items in the Farmers National Bank between February 5, 1929 and the close of business on January 7, 1932, was $30,548.61 (R. 68).

The District Court held that there had been tracing of the proceeds of the four items in question into the cash in

the hands of the Receiver; that the proceeds collected from said items had been intermingled with the cash of the bank and treated as its own (R. 69), and that a preferred claim should be allowed.

The Circuit Court of Appeals in its opinion (R. 86) adopted the doctrine of *Schumacher v. Harriett*, 52 Fed (2) 817, saying that the facts in the Harriett case were analogous to the instant case, and affirmed the District Court's judgment endorsing thereby the doctrine of tracing set forth in the Harriett case (R. 82).

III.

REASONS FOR GRANTING THE WRIT.

The Facts in the Case are not in Dispute. Petitioner Complains of the Construction of Said Facts as a Matter of Law Wherein it was Held That by Virtue of the Doctrine of Schumacher v. Harriett, Supra, Tracing to the Bank Receiving of the Proceeds of the Four Items has Been Shown in the Instant Case.

Petitioner believes that the writ of certiorari should be granted because:

(a) The decision and decree of the Circuit Court of Appeals involves a Federal question relating to the rights of creditors against National Banks under the National Banking Laws, and the decision of the Circuit Court of Appeals appears to be in conflict with the principles of law established in analogous cases by this Honorable Court. *Pottorff v. Texas & Pacific R. R.*, 291 U. S. 245, 261; *Blakey v. Brinson*, 286 U. S. 254, 262; *Schuyler v. Littlefield*, 232 U. S. 707, 710, 713; *Cunningham, Trustee of Ponzi v. Brown*, 265 U. S. 1, 11; *St. Louis and San Francisco R. R. v. Spiller*, 274 U. S. 304, 310.

(b) The decision of the Circuit Court of Appeals in adopting in the instant case the doctrine of *Schumacher v. Harriett, supra*, as to tracing ignores and is in conflict with

the principles of law established by decisions of the Circuit Courts of Appeal in analogous cases in other Circuits. *American Can. Co. v. Williams*, 176 Fed. 816; *American Can Co. v. Williams* (C. C. A. 2), 178 Fed. 420; *Mechanics & Metals National Bank v. Buchanan* (C. C. A. 8), 12 F. (2) 891; *Empire State Surety Co. v. Carroll County* (C. C. A. 8), 194 F. 593; *Farmers National Bank v. Pribble* (C. C. A. 8), 15 F. (2) 175; *Spurway v. Kellogg* (C. C. A. 5), 63 F. (2) 883; *Dickson v. First National Bank* (C. C. A. 8), 26 F. (2) 411; *Schilling v. Rowe* (C. C. A. 9), 64 F. (2) 188; *Burnes National Bank v. Spurway* (C. C. A. 8), 28 F. (2) 40; *First National Bank v. Williams* (C. C. A. 4), 15 F. (2) 585; *Rorebeck v. Benedict Flour & Feed Co.* (C. C. A. 8), 26 F. (2) 440; *Larabee Flour Mills v. First National Bank* (C. C. A. 8), 13 F. 330, certiorari denied 273 U. S. 727; *Beard v. Independent District of Pella City* (C. C. A. 8), 88 F. 375; *Titlow v. McCormick* (C. C. A. 9), 236 F. 209.

The foregoing cases in the various circuits, and the decisions of this Honorable Court, above cited, establish the principles of law *that a preferred claim can be allowed against the estate of an insolvent only where* (1) the relationship is that of trustee and cestui que trust; (2) the transaction with the claimant resulted in augmentation or increase of the assets of the insolvent by the property of the claimant or the proceeds thereof in the form of actual cash or other tangible assets (as distinguished from the establishment and appropriation or dissipation of a deposit or book credit); (3) that such property or assets of the claimant, or other property identified as being in lieu thereof, can be traced into the hands of the receiver or trustee taking over the assets of the insolvent at the time of suspension or bankruptcy, and (4) that the burden of showing the facts of augmentation and tracing is upon the preferred claimant and that the law will not presume augmentation and tracing.

Assuming such principles of law to be controlling in the

establishment of preferred claims, it would appear that the decision of the Circuit Court of Appeals is clearly contrary to such principles for the reasons that augmentation and tracing did not exist in the instant case, except as to the sum of $643.24, the proceeds of the Veesaert bonds included in the low balance in this amount in the account with the First National Bank of Chicago, and the court was in error in its construction of the principles of law relating to augmentation and tracing.

(c) The Circuit Court of Appeals has decided an important question of general law relating to insolvent estates, in a way probably untenable and in conflict with the weight of authority indicated by the foregoing decisions.

(d) The precise kind of case decided by the Circuit Court of Appeals has not, apparently, heretofore been passed upon by this Court. Since the decision of the Circuit Court of Appeals in this case and the decision in the *Schumacher v. Harriett case, supra*, the indications are that if the principles established by the decision in the Schumacher case and in the instant case are permitted to stand, the basis and scope of claims against insolvent national banks in receivership will be very substantially broadened, and a considerable additional number and amount of claims will have to be allowed, to the detriment of the general creditors. We feel that the importance of the case from this aspect alone merits consideration by this Court.

It is felt further that in the interest of establishing uniformity in the various circuits, this Honorable Court should pass upon the questions of law in issue in the instant case, as was done in the case of *Jenkins, Receiver, v. National Surety Co.*, 277 U. S. 258.

WHEREFORE it is respectfully prayed that the petition for writ of certiorari be granted.

JESSE BLACK, JR.,
JOHN F. ANDERSON,
Attorneys for Petitioner.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934.

No. ———.

ROSS C. ADAMS, Receiver of the Farmers National Bank of Pekin, Illinois, Petitioner,

vs.

EDWIN V. CHAMPION, Trustee in Bankruptcy of JOHN FITZGERALD, Bankrupt, Respondent.

BRIEF IN SUPPORT OF PETITION.

I.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals is reported in 70 Fed. (2nd) 956 and appears in the record at pages 82 to 87. Findings of fact, conclusions of law, and decree of the United States District Court appear in the record at pages 65 to 70.

II.

JURISDICTION.

The decree of the Circuit Court of Appeals was entered April 17, 1934 (R. 87). A petition for rehearing, duly and seasonably filed by the appellant (R. 98 to 107), was denied

on June 13, 1934 (R. 113). Jurisdiction is conferred upon this court to review this cause by writ of certiorari under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. C. Title 28, Section 347).

III.

STATEMENT OF CASE.

A statement of the case is set out in the foregoing petition under the caption, "Summary of Matters Involved," to which reference is here made. Such elaboration of the facts as appears to be pertinent to the discussion will be indicated where appropriate.

IV.

SPECIFICATION OF ERRORS.

(a) The Circuit Court of Appeals held that upon the facts stated the proceeds of the plaintiff's property, held in trust, were traceable into the hands of the Receiver. This was error for the reason that according to the undisputed facts said property, or the entire proceeds thereof, were dissipated prior to the suspension of the bank, except as to the sum of $643.24, the low balance in the account with the First National Bank of Chicago, which the bank Receiver concedes belongs to the claimant, subject to a possible prorating among any other preferred claimants who can trace their proceeds into this low balance.

(b) The Circuit Court of Appeals applied the erroneous rule established in *Schumacher vs. Harriett* (C. C. A. 4th) 52 Fed. (2) 817, and held that irrespective of tracing, a preferred claim in the sum of $8870.07 was proper on the ground that the cash in the bank was impressed with a trust in favor of the bankruptcy trustee. This was error for the reasons that (1) a preferred claim cannot properly be allowed against an insolvent estate unless there is augmentation of assets, and a tracing of these assets or the proceeds

thereof to the Receiver or trustee taking over the estate of the insolvent, and (2) the bank at the time of its suspension had no funds belonging to the plaintiff (except the aforesaid low balance of $643.24 in the First National Bank of Chicago), and (3) the cash in the bank and in any of its correspondent banks (except the $643.24 referred to), was not the cash of the claimant but the property of the bank which came from sources other than the bankruptcy estate, and no part thereof was segregated or intended to be segregated for the use of the claimant.

V.

SUMMARY OF ARGUMENT.

Under the Federal rule settled by decisions of this Honorable Court and by decisions of the Circuit Courts of Appeal, one seeking to establish a preferred claim against the funds in the hands of the Receiver of an insolvent National Bank for the benefit of all the creditors must affirmatively prove that a trust relationship exists, that the assets of the bank were augmented by the transaction and that the trust property or its proceeds is traceable into the hands of the bank Receiver. The burden of proof is upon the claimant and must be resolved in favor of the bank Receiver, who is the trustee for general creditors. In the present case the four items in question are conceded by the Receiver to have been acquired by the now insolvent National bank in trust and all were disposed of by the bank prior to its suspension. In exchange for three of the trust items the bank received nothing but transfers of credits already in the bank, and these transfers of credit did not augment the bank's assets and do not permit tracing to the Receiver. In exchange for the fourth item, the Veesaert bonds, the bank received a check in the amount of $1597.31, drawn on an outside bank, which augmented its assets. However, prior to its suspension, these proceeds were dissipated by use of the same in payment of the bank's in-

debtedness, except as to that portion thereof contained in the aforesaid low balance in the First National Bank of Chicago of $643.24, which amount should be fixed as the amount of the preferred claim rather than the sum of $8870.07 erroneously fixed by the Circuit Court of Appeals. The tracing of funds principle of the Harriett decision, *supra*, relied on by the Circuit Court of Appeals in its allowance of a preferred claim in the amount of $8870.07, has *no* application to three of the trust items totaling $7272.76 and its application to any of the items was erroneous because the principle is in clear conflict with the principles contained in the decisions of this Honorable Court, and the decisions of many United States Circuit Courts of Appeal.

VI.

ARGUMENT.

A. The Necessary Elements of a Preferred Claim, and the Rule Stated as to Augmentation and Tracing.

Section 5236 United States Revised Statutes (Section 194, Title 12, U. S. C. A.), relating to insolvent national banks in receivership, contemplates that the assets thereof shall be distributed pro rata among all of the creditors and claimants. No provision is made in the National Banking Laws for preferred claims. The Courts have, however, established a basis for preferred claims where the claimant can show that the Receiver has, among the assets, identifiable property belonging to the claimant. In working out the formula or procedure for establishing such claims, the Federal Courts have held that the claimant must show, by the burden of proof, that from the transaction of the claimant with the bank before suspension the bank received property of the claimant in trust; that the property so received actually augmented the existing assets of the bank by way of adding thereto cash or other property (as distinguished from the addition of a bookkeeping credit); and that the

augmented assets, or the proceeds thereof, are traceable into the assets taken over by the Receiver. If for example a bank receives an item for collection and remittance under circumstances creating a trust relationship, and collection is made in the form of cash (as distinguished from the receipt in payment of a check drawn upon the bank) or if a bank receives cash funds in trust for a specific purpose, it is considered that the existing assets of the bank have been augmented or increased by the trust property, and consequently if it can be shown further that said trust property was not dissipated by the bank prior to suspension, but on the contrary the trust funds, or other funds constructively in lieu thereof, were retained by the bank and were taken over by the receiver at suspension, a preferred claim will be allowed. This rule is summarized in the decision of the Circuit Court of Appeals for the Eighth Circuit in *Empire State Surety Company v. Carroll County*, 194 Fed. 593, 603, 604, 606. In that case the bank had improperly received deposits and had fraudulently represented that it was solvent. In stating the applicable principles of law concerning preferred claims, the Court said:

> "This is a suit in equity against the Receiver of a National bank to require him to take from the ratable dividends of other creditors of the bank the requisite amount to pay the county's claim in full. The receiver must make the distribution of the property of this bank in accordance with the provisions of the National Banking Law. It is the dominant purpose and requirement of that law that, after provision for a redemption of its notes is made, the proceeds of an insolvent National bank shall be equally distributed among its unsecured creditors. So imperative is this provision that it repeals a former act of Congress giving a preference to the United States and annuls a statute of a state giving a preference to deposits of savings banks. *Rev. St. sec. 5236* (U. S. Comp. St. 1901, p. 3508); *Davis v. Elmira Savings Bank*, 161 U. S. 275, 285, 16 Sup. Ct. 502, 40 L. Ed. 700; *National Bank v. Colby*, 21 Wall. 609, 613, 614, 22 L. Ed. 687. The burden, therefore, is

on the sureties to prove clearly that they are entitled on equitable principles to the preference they seek. They proved that the bank took the deposits of the county and of its other depositors in trust for them respectively. But this was not enough. They were also required to prove that these deposits or their proceeds, or a certain part of them, came to the hands of the Receiver, for he is liable to cestuis que trustent to pay trust funds in full only to the extent that he receives them.

* * * * * * * * *

"It is indispensable to the maintenance by a cestui que trust of a claim to preferential payment by a Receiver out of the proceeds of the estate of an insolvent that clear proof be made that the trust property or its proceeds went into a specific fund or into a specific identified piece of property which came to the hands of the Receiver, and then the claim can be sustained to that fund or property only and only to the extent that the trust property or its proceeds went into it. It is not sufficient to prove that the trust property or its proceeds went into the general assets of the insolvent estate and increased the amount and the value thereof which came to the hands of the Receiver.

* * * * * * * * *

"But checks of third persons on the bank with which they are deposited which are paid by crediting the bank and charging the drawers on its books fail to increase the cash in its possession and form no basis for a preferential payment to the depositor. *Beard v. Independent District of Pella City*, 88 Fed. 375, 382, 31 C. C. A. 562.

"Moreover, the deposit of checks of third persons which are credited to the depositor and used by the bank to pay its debts bring no money into its fund of cash and form no foundation for preferential payment to the depositor. *City Bank v. Blackmore*, 75 Fed. 771, 773, 21 C. C. A. 514."

To the same effect see:

Second Circuit:
American Can Company v. Williams, 178 Fed. 420.
Sixth Circuit:
Brennan v. Tillinghast, 201 Fed. 609, 612, 613.
Eighth Circuit:
Larabee Flour Mills v. First National Bank, 13 Fed. (2nd) 330, certiorari denied, 273 U. S. 727.
Beard v. Independent District of Pella City, 88 Fed. 375, 382, 383.
Hirning v. Federal Reserve Bank, 52 Fed. (2nd) 382.
Ninth Circuit:
Titlow v. McCormick, 236 Fed. 209, 211, 212.
Tenth Circuit:
Blumenfeld v. Bank, 38 Fed. (2nd) 455.

Also see:

Schuyler v. Littlefield, 232 U. S. 707, 710, 713;
Cunningham, Trustee of Ponzi v. Brown, 265 U. S. 1, 11;
St. Louis & San Francisco R. R. v. Spiller, 274 U. S. 304, 310;
Blakey v. Brinson, 286 U. S. 254, 262, 263.

B. The Appropriation of a Deposit or Credit Balance Does not Result in Augmentation but Merely in a Shifting of Bookkeeping Credits.

The Federal Courts have held that the shifting or appropriation of a deposit or credit balance in a bank, whereby such shifted deposit or credit balance accrues to the bank, either as trustee or otherwise, contributes no additional assets, and creates no additional fund in the bank, and that consequently augmentation of existing assets does not occur. This situation frequently arises where an item has been forwarded to a bank for collection against one of its depositors, and the bank receives in trust in payment of the item a check of the debtor drawn upon his deposit account. In such case a charge is made to the debtor's deposit balance, and a corresponding credit, for remittance

purposes, is made in favor of the owner of the item. In such case no new funds accrue to the bank, and there has been merely a shifting of bookkeeping credits, and consequently there has been no augmentation. Under such circumstances a preferred claim cannot be allowed, according to the Federal decisions. In a recent case in the Eighth Circuit, *Hirning v. Federal Reserve Bank*, 52 Fed. (2nd) 382, 386, the Court, in discussing these principles, said:

> "It is contended by the appellee that the checks sent by the Reserve Bank to the Brookings Bank constituted a trust fund, and that this trust fund has been traced into the currency and collection items sent by the Brookings Bank to the Reserve Bank.
>
> "The trial court seems to have adopted this view as one of the grounds of its decision in ordering judgment for defendant.
>
> "*We do not agree with this contention.* It must be remembered that the checks sent to the Brookings Bank by the Reserve Bank were all of them checks drawn on the Brookings Bank. When the Brookings Bank accepted the checks, this produced no additional funds in its hands. Its assets were not augmented. *No trust fund was created. If there was no trust fund, there could, of course, be no tracing of the trust fund into any assets of the Brookings Bank.* The doctrine that a trust fund is created when checks drawn on bank A by a depositor therein are sent to bank A by bank B for collection, *i. e.*, for payment, has been disapproved by the decisions in this Circuit, as has also the doctrine that the forwarding bank or its principal has a general lien on the assets of the drawee bank for the payment of such checks. *Rorebeck v. Benedict, etc. Co.*, 26 Fed. (2) 440; *Farmers National Bank v. Pribble*, 15 Fed. (2) 175; *Larabee Flour Mills v. First National Bank*, 13 F. (2) 330; *Macy v. Roedenbeck*, 227 Fed. 346, 352; *Beard v. Independent Dist.*, 88 Fed. 375."

To the same effect are the cases in the various Circuits cited in paragraph A preceding.

In the instant case four items designated as (1) bank stock, (2) Graff note, (3) Sommer note, and (4) Veesaert

bonds, were received by the bank in trust. All of these items were disposed of by the bank prior to the appointment of the Receiver. In exchange for item 1 (the bank stock), the bank received no new assets but made a charge against a deposit balance in the bank to the credit of Cullinan (R. 50, 51). In exchange for item 2, the Graff note, the bank received no new assets but did receive its own certificates of deposit representing a charge against an existing deposit balance (R. 54), and the same is true of item 3, the Sommer note (R. 54). The claimant is a stranger to the transactions between the bank and Cullinan, Graff and Sommer from which the credit balances were built up in the names of these individuals, which credit balances were subsequently charged incident to the surrender of these three trust items. When the bank created a credit balance in favor of Cullinan based upon his note, Cullinan had the absolute right to draw and the bank became obligated to pay the deposit balance. Subsequent collections on the note were incident to the separate contract between Cullinan and the bank as to which the claimant is an absolute stranger. Thus prior to the surrender of the three trust items the relationship betwen the bank and Cullinan, Graff and Sommer had become that of debtor and creditor, hence the bank Receiver can be required to account for nothing but these transfers of credits as a general claim only. *Blakey v. Brinson*, 286 U. S. 254; *Allied Mills v. Horton*, 65 Fed. (2nd) 708; *Larabee Flour Mills v. First National Bank of Dublin*, 69 Fed. (2nd) 351; *City of Miami v. First National Bank*, 69 Fed. (2nd) 346; *Larabee Flour Mills v. First National Bank*, 13 Fed. (2nd) 330, certiorari denied, 273 U. S. 727; *Ellerbe v. Studebaker Corp.*, 21 Fed. (2nd) 993.

In principles the claimant in the instant case, as to the bank stock, Graff, and Sommer items, is in exactly the same position as was the preferred claimant in *Allied Mills, Inc. v. Horton*, recently decided by this Circuit Court of Appeals, reported in 65 Fed. (2nd) 708. In the Allied Mills

case the bank received an item, the property of the claimant, and surrendered it in exchange for transfers of credit already on its books, and the court properly classified the claim as general only. In the instant case the bank received the bank stock, the Graff and the Sommer items, as the property of the claimant, and surrendered them in exchange for transfers of credit already on its books, but the court allowed a preferred claim. An application of the principles stated in the following excerpts from the recent opinion of the court below in the Allied Mills case, pages 710 and 711, to the facts in the instant case, surrounding the bank stock, Graff and Sommer items, seems conclusively to classify the claim on these items as general only, and to exclude the claimant from any possible interest in the proceeds ultimately collected from Cullinan on his note and from any interest in the collection proceeds of the items deposited in the bank by Graff and Sommer to build up the credit balances, subsequently exchanged for the three trust items.

> "It is a rule of general application in Federal courts that where checks on the collecting bank are deposited in the same bank to meet a draft which the bank holds for collection, no trust in the funds thus deposited arises in favor of the drawer of the draft. *Hirning v. Federal Reserve Bank* (C. C. A. 8), 52 F. (2d) 382, 82 A. L. R. 297 change position of C. C. A. 8 to conform to other citations; *Larabee Flour Mills Co. v. First National Bank, of Dublin, et al.*, 52 Fed. (2nd) 146 (D. C.); *Larabee Flour Mills v. First National Bank of Henryetta, Okla.*, 13 Fed. (2nd) 330 (C. C. A. 8); *Empire State Surety Co. v. Carroll County, et al.*, 194 F. 593 (C. C. A. 8). The reason generally assigned in the cases is that in such transactions there is no augmentation of the assets of the bank. There is merely a transfer of existing assets of the bank from one to another.
>
> "If Crisp had brought into the bank the cash wherewith to pay this draft and had paid it in for that specific purpose, the assets of the bank would have been augmented by the cash thus brought in, and a trust

might then arise in favor of the drawer of the draft in case the bank fails to pay, and the funds coming into the bank are traceable.

* * * * * * * * *

"It is insisted that in any case the $105 of cash which Crisp deposited that day augmented the bank's assets by so much and should be held to constitute a trust. The instant this deposit was made the bank became debtor to Crisp, and the deposit became part of the bank's general assets. The fact that Crisp intended to use it to take up these sight drafts is immaterial. It may be presumed that one's checking account in a bank is intended sooner or later to be devoted to the uses of the depositor. This does not constitute such deposit a trust fund either for the benefit of the depositor or for such person or persons for whose use or benefit the depositor may intend to devote the account."

In exchange for item 4, the Veesaert bonds, the bank received a check in the amount of $1597.31, drawn on an outside bank which was passed to its credit with the First National Bank of Chicago. The record (P. 59) establishes that there was a subsequent low balance in this account of $643.24, the remainder having been dissipated through use by the bank in the payment of its debts. This subsequent dissipation limits the preferred claim accordingly, it being clear that any deposits in the account at Chicago after the low balance in question consisted of funds other than those of the claimant, for as stated by this Circuit Court of Appeals in its recent opinion in *Connolly v. Lang*, 68 Fed. (2nd) 199, 201:

"If the trust is once depleted, it can not be built up by subsequent deposits of other depositors. *Schuyler v. Littlefield, supra; Blumenfeld v. Union National Bank* (C. C. A.), 38 F. (2d) 455; *In re Brown* (C. C. A.), 193 F. 24."

C. There was no Valid Basis for Attempting to Impress the Cash in the Bank With a Trust in Favor of the Trustee in Bankruptcy Based Upon the Bank's Receipt and Subsequent Surrender of the Four Trust Items.

The Court below held that irrespective of the factor of tracing, the cash in the bank at the time the bank received the trust items or disposed of them was impressed with a trust in favor of the bankruptcy trustee to the extent of the value of the trust items, $8870.07, it appearing (R. 67, 68) that the cash on hand in the bank at all times thereafter until suspension exceeded this amount. This conclusion is erroneous because the record facts about which there is no dispute, clearly establish that not one penny of the proceeds of the four items held in trust went into the cash on hand in the bank.

It is the settled rule of the federal courts that the burden is upon the claimant for a preference to trace the proceeds of the trust property into the hands of the receiver, and that uncertainty or inability to show such tracing must result in denial. *Schuyler v. Littlefield, supra.* In this connection, this Court in its recent opinion in *Texas & Pacific Railway Co. v. Pottorff, Receiver*, 291 U. S. 245-261, said:

> "The claimant has the burden of identifying the property in its original or altered form. *Schuyler v. Littlefield*, 232 U. S. 707. It is not enough to show that at the time of receipt the general assets of the insolvent were increased or that debts were discharged."

In discussing a trust claimant's burden of proof incident to the tracing of proceeds of the transaction into the hands of the trustee of a bankruptcy estate this Court, in the opinion in *Schuyler v. Littlefield*, 232 U. S. 707-713, said:

> "All these claims were disallowed because of the failure to make the requisite proof. Our investigation of the facts leads us to the same conclusion so far as concerns the appellants' claim. They were practically

asserting title to $9,600 said to have been traced into stock in the possession of the Trustee. Like all other persons similarly situated, they were under the burden of proving their title. If they were unable to carry the burden of identifying the fund as representing the proceeds of their Interborough stock their claim must fail. If their evidence left the matter of identification in doubt the doubt must be resolved in favor of the Trustee, who represents all of the creditors of Brown & Co., some of whom appear to have suffered in the same way. Like them, the appellants must be remitted to the general fund."

The record in this case permits definite ascertainment of the disposition of the four items in question and their proceeds, and it clearly shows that none of these proceeds are traceable into the cash on hand in the bank that passed to the receiver at suspension. The only property passing into the hands of the bank receiver that contained any proceeds of the trust transaction was the balance he received from the First National Bank of Chicago, a correspondent bank, in connection with item No. 4 which contained the trust claimant's low balance of $643.24 (R. 59).

D. The Tracing of Funds Doctrine of Schumacher v. Harriett, 52 Fed. (2d) 817, Relied on by the Appellate Court for the Allowance of a Preferred Claim in the Instant Case is Erroneous Because in Conflict With the Decisions of This Court and Many Decisions of the United States Circuit Courts of Appeal.

In the Harriett case the bank received from the preferred claimant certain checks, representing the proceeds of life insurance, with instructions to purchase bonds with the proceeds, a trust transaction. The bank received credit for the checks in its accounts with Richmond and New York correspondents and, prior to suspension, dissipated the proceeds in payment of its debts. In allowing the preferred claim, the Appellate Court used the following lan-

guage in holding that the proceeds of the checks were traceable to the bank receiver (52 Fed. (2d) 819):

> "The life insurance checks were received by the bank as cash and were treated by it as such. They increased the cash and cash items in the tills of the bank at the time. When it placed them to its credit in the Richmond and New York banks, it was dealing with them as its own; and the presumption is that cash which was left in its tills was intended to be subject to the trust. While it had, of course, the right to collect the checks, it had no right to place their proceeds to its credit in other banks without holding an equivalent amount in cash in its own vaults to satisfy the trust which it had assumed towards plaintiff; and we must assume that it respected the trust, as 'equity imputes an intention to fulfill an obligation.'"

The facts in the Harriett case establish that none of the proceeds of the claimant's trust transaction passed into the hands of the bank receiver; hence the Circuit Court of Appeals should have classified the claim as general only. The case was a companion case to that of *Schumacher v. Brinson*, 52 Fed. (2d) 821, which was unanimously reversed by this Court as *Blakey v. Brinson*, 286 U. S. 254. The Harriett case is in conflict with the principles applied by this Court in the above excerpt from the opinion in *Schuyler v. Littlefield* and with its dictum, quoted above, in *Texas & Pacific Railway Co. v. Pottorff*, and with the principles established in *Blakey vs. Brinson*. This Court refused to review a contrary conclusion reached in *United States National Bank v. Centralia* 240 Fed. 93, certiorari denied 243 U. S. 656.

The tracing of funds principle in the Schumacher case stood alone until adopted by the Circuit Court of Appeals in the instant case and it has been repeatedly criticized. The annotator who prepared the exhaustive annotation in 82 A. L. R., beginning at Page 46, said on Page 203, in referring to this particular decision, that:

> "It is not altogether in harmony with the foregoing decisions."

The author of an article appearing in Volume 80, Pennsylvania Law Review, at Page 587, says, referring to the same decision:

> "It would seem that this decision would result in a recrudescence of the discredited doctrine which permitted a preference merely on proof that the assets had been increased by the trust property."

In the recent opinion of the Circuit Court of Appeals for the Fifth Circuit in *First National Bank, St. Petersburg v. City of Miami*, 69 Fed. (2d) 346, which was twice certified to this Court and the certificates dismissed on jurisdictional grounds, the Appellate Court discusses the "liberal" rules on tracing of funds but follows the settled federal rule and classifies the claim asserted as general only. The Court of Appeals for the Fifth Circuit declined to follow the Harriett tracing rule in its decision in *Pottorff v. Key*, 67 Fed. (2d) 833, and it comments adversely on the rule in its opinion in *Wisdom v. Keen*, 69 Fed. (2d) 349.

The Harriett tracing rule is in conflict with the rule stated by the Circuit Court of Appeals of the Eighth Circuit in one of the leading cases in this country on the question, that of *Empire State Surety Company v. Carroll County*, 194 Fed. 593, wherein the court requires, on Page 604, that:

> "Clear proof be made that the trust property or its proceeds went into a specific fund or into a specific identified piece of property which came into the hands of the receiver."

A review of the following cases will establish that the Harriett case stands as a solitary decision without support in the federal decisions, except in the instant case, and is opposed to the rule announced in every other Circuit of the United States. *American Can Co. v. Williams*, 178 F. 420, 422; *Commissioners of Crawford County v. Strawn*,

157 F. 49, 15 L. R. A. (N. S.) 1100; *Cuttell v. Fluent*, 51 F. (2d) 974; *Macy v. Roedenbeck*, 227 F. 346, 355; *First Nat. Bank v. Fidelity & Deposit Co.*, 48 F. (2d) 585; *Anadarko Cotton Oil Co. v. Litteer*, 300 F. 222; *Horse Co. v. Americus Nat. Bank*, 230 F. 738; *Banking Co. v. Fourth Nat. Bank*, 38 F. (2d) 772; *Sanders v. Stevens*, 51 F. (2d) 743; *Brennan v. Tillinghast*, 201 F. 609; *Gwynn v. Spurway*, 28 F. (2d) 37; *Dudley v. Richards*, 18 F. (2d) 876; *Titlow v. McCormick*, 236 F. 209; *Dickson v. First Nat. Bank*, 26 F. (2d) 411.

CONCLUSION.

It is believed that the foregoing discussion demonstrates that the decision of the Court below is contrary to the pertinent principles of law established in the Circuit Courts of Appeal in the Circuits other than Fourth and Seventh Circuits, and to the principles established by the decisions of this Court. It is earnestly urged, in the interest not only of uniformity in the administration of national banks throughout all of the Circuits, but also in the interest of settling conclusively what the law is upon the issues involved, that this Court entertain a review of this case on writ of certiorari, and we submit, in the light of the reasons indicated, that the petition should be granted.

JESSE BLACK, JR.,
JOHN F. ANDERSON,
Attorneys for Petitioner.